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Real estate investors from other states find bargains in Pittsburgh

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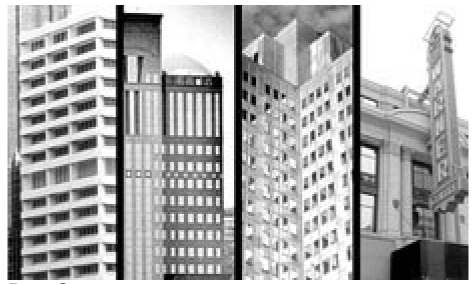
By Elwin Green, Pittsburgh Post-Gazette



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From left to right: National City Center Building, CNG Tower, Three Gateway Center, Warner Centre

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The recent sales of the National City Center building to a New York-based investment group and of the Verizon building to a Santa Monica, Calif., investor are just the latest noteworthy instances of a trend that local brokers say has been growing for two years: Out-of-state investors from hot real estate markets are taking advantage of bargains to be found in Pittsburgh.

Consider: The buyer of the Verizon building, Judah Hertz, bought the four towers of Gateway Center in December 2004. A month later, the New York-based Blackstone Group bought Dominion Tower. Another New York developer, J.J. Operating Group, bought Warner Centre in June and Metropolitan Life bought One Mellon Center in July. Then came last month's sales of National City Center and the Verizon building.

And those are just the bigger deals.

"It's nuts," said Gregg Broujos, a principal with brokerage firm NAI Pittsburgh Commercial.

"In Pittsburgh, there's not enough product. There is a lot of available capital and available financing chasing real estate."

Thomas P. Sullivan, industrial/commercial broker at Colliers Penn, echoed the sentiment, saying, "We're getting close to the point where we're running out of things for people to buy."

At CB Richard Ellis, Executive Vice President Jeffrey B. Ackerman said that 70 percent of his sales in the past two years have been to out of state buyers.

To understand why so many out of state buyers are coming to Pittsburgh, imagine a three-tiered fountain, with the flow of water representing the flow of cash. The first destination for the cash, the top tier, is a handful of hot markets such as New York, Miami and Los Angeles. As that tier fills, and the cash keeps flowing, it overflows to secondary markets within a two- to three- hour drive of the top-tier cities. Then, with more cash still flowing, it spills over into markets that are not so close to the hot spots, markets where bargains can still be found -- markets such as Pittsburgh.

"These investors are tapped out of the larger markets and now they're looking at Pittsburgh," Mr. Broujos said.

He could have been describing Robert S. Blanchard, director of acquisitions for Sun1031 LLC, a Phoenix-based real estate investment firm.

With a population that has exploded by 39 percent from 1995 to 2004, and unemployment rates below the national average, Phoenix could reasonably be described as a hot real estate market. But Mr. Blanchard is a repeat buyer in the Pittsburgh area, having most recently closed on the Goodyear Center, a 15,000-square-foot retail complex in North Fayette, in a transaction brokered by Mr. Ackerman.

"We like the market," Mr. Blanchard said, "Things have evolved very positively [in Pittsburgh] in the past few years."

The company buys properties, then sells off most of the equity in them to groups of individual investors. In doing so, they take advantage of the growing popularity of a type of transaction and a type of ownership that were both relatively unknown until a few years ago.

The transaction is called a 1031 exchange, and it involves using the proceeds from the sale of an investment property to buy another investment property according to rules established in Section 1031 of the Internal Revenue Service code. The type of ownership involved is Tenant in Common (TIC), a form of ownership in which multiple owners each own an undivided interest in the property.

TICs and 1031 exchanges have been around for decades, but it was only in 2002 that the IRS declared that a TIC purchase could qualify as the second half of a 1031 exchange. That ruling, combined with skyrocketing property values, led longtime owners of investment real estate to cash out and reinvest their proceeds in the partial ownership of larger properties.

With a roster of buyers who are flush with pretax cash looking for replacement properties to complete their exchanges, companies like Sun1031 "have a voracious appetite," Mr. Ackerman said, "and many times will outbid local buyers."

Sometimes the out-of-towners even outbid each other. Gary DeSanto, whose DeSanto 1031 LLC also buys properties for resale to TIC investors, has been outbid on a couple of Pittsburgh properties. But DeSanto, based in suburban Philadelphia, is still looking here.

"Pittsburgh has definitely become a competitive market," Mr. DeSanto said.

Despite their protests about running out of inventory, local brokers say that as long as low interest rates make financing affordable and make the returns on real estate attractive, there will be 1031/TIC investors ready to buy.

"Most TIC funds are gobbling up properties as fast as they can," Mr. Ackerman said.

In fact, Pittsburgh soon may become a target for international investors, as Mr. DeSanto said that he is now working with a European fund looking for a higher rate of return than it can get at home.

In a world awash with cash, global investment in commercial real estate reached $475 billion in 2005, a 21 percent increase over 2004, according to real estate services and money management firm Jones Lang LaSalle. And an increasing portion of it is flowing into the United States from abroad. An industry trade journal, National Real Estate Investor, quoted Tony Horell, chief executive officer of Jones Lang's international capital group, as saying: "Last year, for every dollar of completed transactions, there were two dollars chasing the deals. This year there are three dollars."

For the foreseeable future, it appears that more of those dollars will flow into Pittsburgh.

"There's a lot of equity out there," Mr. DeSanto said.

(Elwin Green can be reached at egreen@post-gazette.com or 412-263-1969.)

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